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FM AMEMBASSY VIENNA
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C O N F I D E N T I A L SECTION 01 OF 03 VIENNA 000728

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E.O. 12958: DECL: 03/22/2017
TAGS: [ENRG](#) [EPET](#) [EINV](#) [AU](#)
SUBJECT: NABUCCO PIPELINE: OMV STILL BULLISH ON 2012 STARTUP

REF: VIENNA 701

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Classified By: Economic-Political Counselor Gregory E. Phillips for reasons 1.4 (b) and (d)

Summary

¶1. (C) During a March 20 meeting with EconUnit Chief, the Managing Director of the Nabucco Pipeline consortium, Reinhard Mitschek, said that the project remains on track to begin operations in 2012. Nabucco is still looking to take on a major European gas company to help finance the project. Requests for exemptions from the EU's Internal Gas Market Directive are with national regulators. Azeri gas is key for Nabucco's startup phase. OMV will meet with Azeri officials, including President Aliev, in mid-April, and will consider asking for a 10 billion cubic meter (bcm) commitment to Nabucco in exchange for a 10% stake in the project. Nabucco would like to include Transcaspian gas in the Nabucco mix in the long-term. In the short-term, without sufficient Azeri supplies, Nabucco would consider less desirable sources, including Russia or Iran. OMV does not oppose Turkey's efforts to establish a gas hub, as long as it does not slow progress on Nabucco. Mitschek brushed aside last week's news headlines that "Hungary had chosen Gazprom over Europe," adding that a "South Stream" pipeline would face many obstacles, including Romanian and Bulgarian opposition. Mitschek opined that Russia is angling to participate in Nabucco as a way to dampen Europe's interest to access Kazakh and Turkmen gas, thus condemning Transcaspian gas to export only to Russia. According to Mitschek, OMV does not oppose Russian gas in Nabucco, but it definitely will not allow Russian control of the project. End Summary.

OMV: Nabucco Timeline Still On Track

¶2. (C) During a March 20 meeting with EconUnit Chief, Reinhard Mitschek, OMV's Managing Director of the Nabucco Pipeline consortium, said he remains confident that the pipeline will be operational by 2012. In spring 2007, engineers will develop a front-end design and specifications for the project. Required environmental and social impact assessments will occur later in 2007, and in 2009 construction will commence.

¶3. (C) Nabucco is presently lining up contracts with companies to produce the unusually thick (56 inch diameter) pipe. Mitschek noted that 6-7 potential shippers in Europe have already signed Letters of Intent with Nabucco, which will come into effect as soon as Nabucco reaches a final investment decision in late 2007 or early 2008. Mitschek admitted that Nabucco is still seeking financing from a major European gas company. Government export/investment banks in

Austria, Germany, Italy, France, and Japan, as well as the EBRD, have apparently agreed to provide financing guarantees for Nabucco.

Nabucco Seeking Exemptions from EU Directive

¶4. (C) Mitschek said that the consortium is seeking two important exemptions from the European Commission: a long-term unregulated tariff to protect against national regulators capriciously reducing tariffs; and reserving 50% of initial capacity for operators participating in Nabucco. Mitschek stressed that both exemptions are important to attract additional financing. Mitschek said Nabucco has already filed requests for an unregulated tariff regime with regulators in Austria, Hungary, Romania, Bulgaria, and Turkey. Mitschek said the EC would make the final decision on exemptions, once it had received approvals from national regulators.

Lining Up Suppliers

¶5. (C) Mitschek said Nabucco had identified Azerbaijan, Egypt, and Iraq as the most suitable suppliers for the initial stages of Nabucco. Russia, via Blue Stream, could also contribute 5-6 billion cubic meters (bcm) in an initial phase. However, Mitschek stressed that Nabucco did not want any one supplier to become dominant. Mitschek welcomed continued support for Nabucco in Brussels and Washington, but noted that recent discussions with USG officials on the margins of the February IEA conference indicated the USG is supporting the Turkey-Greece Interconnector (TGI) over Nabucco. Mitschek underlined that "Nabucco will happen. The only question is when -- by 2012 or by 2015."

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Without Azeri Gas, Will Nabucco Turn to Russia or Iran?

¶6. (C) Echoing comments by OMV CEO Wolfgang Ruttenstorfer (reftel), Mitschek underscored that Azerbaijan remains the key for Nabucco's successful startup. Mitschek said OMV reckons that Shah Deniz II can produce 10-16 bcm per annum. However, Nabucco is keenly aware that it is competing with TGI for this gas. An OMV delegation will visit Baku in mid-April. Mitschek said the consortium is considering offering the Azeri state company SOCAR a 10% share in the Nabucco project in return for 10 bcm for the pipeline. Mitschek added that, without Azeri gas, Nabucco would have to look for supplies from less preferred sources, such as Russia or Iran. According to Mitschek, Kazakhstan and Turkmen gas are also potential longer-term suppliers, if there is progress with a Transcaspian Pipeline (TCP). OMV, through its majority holding in Romania's Petrom, has an office in Ashgabat and rights to Kazakh gas fields.

OMV: Turkey Needs Nabucco to Realize Its Goals

¶7. (C) Regarding Turkey, Mitschek said Ankara has become more and more interested in Nabucco, as it looks to meet its growing gas demand. According to Mitschek, Turkey wants to establish an energy hub, so it can act as a gas wholesaler. Mitschek maintained that OMV does not oppose something along these lines, as long as Turkey's "energy hub project" does not slow down Nabucco. Turkey, in Mitschek's view, recognizes that they need the Nabucco infrastructure and financing to realize its goals. Mitschek noted that OMV is uncertain where the real source of decision-making on energy questions in Ankara is: the state planning organization,

Minister of Economy Guller, or, ultimately, Prime Minister Erodgan? Also, what is the extent of Russian influence in Turkey's energy sector?

OMV: Hungary's "South Stream" a Dream

18. (C) Mitschek brushed aside last week's news reports that Hungary had opted for closer cooperation with Gazprom instead of supporting Nabucco. Hungary, in Mitschek's views, "wants it both ways," and Prime Minister Gyurcsany often "says some strange things." Mitschek maintained that Hungary's state energy company MOL has shown an enhanced commitment to Nabucco compared to its position last year. Mitschek conceded that Russia had undoubtedly floated to Hungary the idea of a "South Stream" pipeline transporting gas from Russia to a Hungarian storage facility. However, such a project was more of a diversionary tactic than a real option: a potential route is undefined; Bulgaria and Romania vehemently oppose a competing Russian pipeline; and South Stream would face the same infrastructure and regulatory hurdles that Nabucco is already addressing. Mitschek noted that EC Energy Commissioner Piebalgs was in Budapest on March 0, hopefully to try to steer the GoH back toward a European gas project. According to Mitschek, Gyurcsany would be in Moscow March 22 to discuss energy issues with Russian President Putin.

Russia Angling for Participation in Nabucco?

19. (C) Mitschek agreed that conventional wisdom is that Russia wants to stop any southern corridor gas pipeline in its tracks to indefinitely lock up Kazakh and Turkmen gas (reftel). However, Mitschek said that, perhaps, Russia is pursuing a different tactic to prevent Transcaspian gas from reaching Europe. Mitschek opined that Russia has created the threat of a South Stream competitor to advocate for Russian participation in Nabucco. If significant amounts of Russian gas flows through Nabucco, there will be no pressure to build the TCP, either from producers or suppliers. In this scenario, Russia will remain the sole recipient of cheap Kazakh and Turkmen gas. Mitschek said an additional 10 bcm from Russia would make Nabucco extremely viable. When pressed what form of Russian participation OMV might agree to in Nabucco, Mitschek said "as a supplier, perhaps as a passive shareholder, but certainly not with any operating control."

Comment

10. (C) We take OMV's comments at face value that Azeri gas

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is preferred, but in a pinch, Nabucco may turn to Russian or even Iranian supplies. OMV is taking a medium-term outlook to the geopolitical situation in the region, i.e., that a post-Ahmadinejad Iran will somehow be a more acceptable partner for Nabucco and European governments. OMV rightfully remains wary of Russia's intentions, but believes, if Russian participation is critical to Nabucco's startup, it can manage Gazprom's role within the project. An area of real convergence with USG priorities is OMV's desire to access Transcaspian gas sooner, rather than later.
Kilner